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IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1977
No. 77-1134

STATE OF MONTANA; DEPARTMENT OF REVENUE OF THE STATE OF MONTANA; and W. A. GROFF, as Director of Revenue of and for the State of Montana, and his successors in office,

Appellants,

VS.

UNITED STATES OF AMERICA,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

BRIEF FOR THE STATE OF WASHINGTON AS AMICUS CURIAE IN SUPPORT OF POSITION OF THE STATE OF MONTANA

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I.

INTEREST OF AMICUS CURIAE

This brief is submitted by the State of Washington and is sponsored by the Attorney General of the state; as such, consent to its filing is not required under Rule 42(4) of the United States Supreme Court Rules.

The interest of the State of Washington in the

case at bar may be stated succinctly: if the rationale and decision of the majority of the three-judge district court below are sustained by this Court, Washington together with virtually all other states will be seriously impeded in their efforts to require private profit-making construction companies doing business with the federal government to contribute their fair share of those state taxes necessary for the support of state services, including state services rendered to those companies. More specifically, the State of Washington is itself embroiled before the Ninth Circuit Court of Appeals in litigation with the United States involving state tax statutes somewhat similar to those of Montana challenged here.[1] As such, the decision of this Court in Montana's case may have a very great impact upon Washington's ability to defend its taxes in the federal appellate courts.

There is one additional reason why Washington is particularly concerned about the issues raised in the case at bar. The Montana tax under challenge is a gross receipts tax upon contractors performing construction contracts in Montana for the federal government, state government, or county or municipal governments or school districts in Montana.[2] Yet, Montana's public contractor's gross receipts tax is part of a larger Montana tax structure which includes, among other taxes, a net income tax. By contrast, the State of Washington has no net income tax

[1]*United States of America v. State of Washington, et al., appeal docketed*, No. 78-1424, 9th Cir., February 24, 1978.

[2]R.C.M. 1947 §84-3501(b).

but rather relies chiefly with respect to taxation of economic activities, including performance of construction contracts for the United States, upon a business and occupation tax (a gross receipts tax)[3] and various sales and use taxes.[4]

As such, it is obvious that the decision of this Court in the case at bar concerning Montana's gross receipts tax could have a very major impact in Washington which is not able to rely for part of its revenues upon income taxes.

II.

ARGUMENT

A. Introduction

It is not the intention of the State of Washington in submitting this amicus curiae brief simply to repeat the arguments of appellant State of Montana. Moreover, it is not Washington's intention to address the detailed operation of the Montana statute, leaving that argumentative function to the parties to the litigation.

Rather, this amicus curiae brief has two limited objectives. First, it will focus upon the nature of the interest which Washington believes is protected by the Supremacy Clause of the United States Constitution[5] as related to contentions by the United States that taxes such as Montana's gross receipts tax "discriminate" against the United States or those with

[3]Chapter 82.04 Revised Code of Washington.

[4]Chapters 82.08 and 82.12 Revised Code of Washington.

[5]U.S. Const., Art. VI §1, cl. 2.

whom it deals in contravention of that Clause. More specifically, Washington will argue that proper analysis of the discrimination question shows that the approach taken by the United States in the court below as well as the approach reflected in the majority decision being reviewed by this court are fundamentally unsound.

Second, and more briefly, Washington will argue that the analysis utilized by the majority district court opinion below is fundamentally inconsistent with a 1937 decision of this Court involving the State of Washington.[6]

B. **Montana's Challenged Tax Does Not Abridge Any Interest Protected by the Supremacy Clause.**

In the case at bar, the United States has contended—and a majority of the three judge district court has ruled—that imposition of the Montana gross receipts tax upon public contractors for the federal government is discriminatory for essentially two reasons: (1) when the tax is paid by contractors for the state, the state in its taxing capacity retains that tax as general revenue while similar contracts for the federal government do not engender revenues to the federal government;[7] and (2) the Montana tax is discriminatory because the gross receipts tax discriminates against the federal government in favor of private contractors in the state.[8]

[6]*Silas Mason Co. v. Tax Commission of Washington*, 320 U.S. 186 (1937).

[7]Lower court majority decision, Appendix, p. 13.

[8]Lower court majority decision, Appendix, p. 17.

Washington submits that the majority decision below is in error on both grounds of perceived discrimination. As to the first type of discrimination found to exist by the majority decision below, Washington will argue in Part II(C), *infra*, that this contention and ruling are flatly inconsistent with at least two decisions of this court, namely, *Silas Mason Co. v. Tax Commission of Washington*, 320 U.S. 186 (1937) and *James v. Dravo Contracting*, 320 U.S. 134 (1937).

More generally, Washington submits that the fundamental difficulty with the decision of the majority below and with the contentions of the United States is that neither the United States nor the court below have determined precisely what constitutes "discrimination" in the context of the interests protected or furthered by the Supremacy Clause of the United States Constitution.

It is certainly correct that

> "* * * a [state] tax may be invalid even though it does not fall directly on the United States if it operates so as to discriminate against the Government or those with whom it deals." *United States v. City of Detroit*, 355 U.S. 466, 473 (1958).

See also, *Phillips Chemical Co. v. Dumas School District*, 361 U.S. 376, 387 (1960).

The problem with the decision below is that it proceeds from this "boilerplate" articulation of the general rule against discrimination to a conclusion that discrimination is present with respect to the

Montana statute without any clear analysis of the nature of the concept of "discrimination" which properly should be utilized in cases such as the present one.

At the outset, it is readily apparent that the mere "singling out" of the United States or those with whom it deals by a state tax statute is insufficient in itself to establish a violation of the Supremacy Clause. Surely no one would contend that if a state tax structure imposed a gross receipts tax on all construction activity *except* construction activity performed for the United States that this circumstance would mean that the United States and its contractors were by virtue of this circumstance "singled out" for disparate treatment in violation of the Supremacy Clause. Thus, as this rather extreme example illustrates, mere disparate treatment alone is insufficient to establish the presence of discrimination prohibited by the Supremacy Clause. Put otherwise, for a state tax (whose legal incidence is not upon the United States) to run afoul of the Supremacy Clause, disparate treatment *plus* some additional factor must be established .

Fortunately, this Court has recently provided additional analytical tools for determining what the proper judicial inquiry should be in cases such as the present one and in so doing, the Supreme Court has clarified the nature of the interest which the Supremacy Clause is designed to protect. *United States v. County of Fresno*, 429 U.S. 452 (1977).

The fundamental flaw with the argument of the

United States below and the decision of a majority of the district court is that the argument and decision attempt to proceed from the fact that not all construction contractors are subject to Montana's gross receipts tax to the conclusion that this tax therefore discriminates against federal construction contractors in violation of the Supremacy Clause. Significantly, nowhere in the gap between the fact that not all construction contractors are subject to the tax and the conclusion that the tax therefore violates the Supremacy Clause does there appear any analysis of whether this admittedly disparate treatment with respect to construction contractors gives rise to the type of discriminatory situation against which the Supremacy Clause was meant to guard. The most recent decision on this question in *Fresno*, *supra*, makes manifest that any conclusion, in the absence of this intervening analysis, is without a proper foundation.

In *Fresno*, employees of the United States Forest Service were furnished housing on federal property as partial compensation for services rendered the Forest Service. Because of the fact that the housing these employees "rented" was on tax-exempt property, the employees, under California law, were determined to hold taxable possessory interests in the property and, therefore, were assessed an annual possessory interest tax on their possessory interests in this housing. Such a tax was only imposed upon renters of housing on tax-exempt property. This tax

did not apply to renters of housing on taxable real property. Clearly, then, disparate treatment existed, with certain individuals being taxed because they rented from the federal government while other similarly situated individuals, who did not rent from the federal government, were not taxed. And yet, the Court in *Fresno* wrote:

> "Although the tax is imposed by the appellee counties on renters of real property only if the owner is exempt from taxation—and consequently is not imposed on the vast majority of renters of real property in California—the tax is not for that reason discriminatory." 429 U.S. 452 at 464.

Similarly, the Supreme Court in *United States v. Detroit*, 355 U.S. 466 (1958), recognized that the mere existence of disparate tax treatment, as between those who deal with the federal government and others similarly situated who do not, does not in and of itself compel the conclusion that there exists the type of discriminatory treatment of the federal government which the Supremacy Clause was intended to prevent. Under the Michigan law considered in *City of Detroit*, the user of tax-exempt real property, in a business conducted for profit, was to be subject to taxation to the same extent as if he or she owned the property. Again, the Court acknowledged that while this taxation scheme *did* create disparate treatment and *did* subject those who dealt with the federal government to a tax not imposed upon all individuals who used real property in a business conducted

for profit, still this scheme of taxation did not create the type of discriminatory situation to which the Supremacy Clause was addressed. Referring to the class of individuals singled out for this tax, the Supreme Court said:

> "But here the tax applies to every private party who uses exempt property in Michigan in connection with a business conducted for private gain. Under Michigan law this means persons who use property owned by the Federal Government, the State, its political subdivisions, churches, charitable organizations and a great host of other entities. The class defined is not an arbitrary or invidiously discriminatory one." 355 U.S. 466 at 473.

Thus, *Fresno* and *City of Detroit* stand for the proposition that the mere fact of dissimilar state tax treatment, as between an individual who deals with the federal government and an individual who has the same dealings with an entity other than the federal government, does not *of itself* render the state tax invalid.

Washington submits that the import of these decisions is to require a further and more precise analysis of Montana's disparate treatment of federal versus state or federal versus private contractors to determine whether this treatment creates or has the potential to create the type of discriminatory situation which the Supremacy Clause of the Federal Constitution is intended to prevent.

The most recent and thorough discussion of the particular evil with respect to state taxation which

the Supremacy Clause was intended to prevent, occurs in *Fresno*.

As one commentator has observed, the result in *Fresno* could well have been reached by the Supreme Court simply by a per curiam opinion affirming the California court and citing, *inter alia*, *City of Detroit*, *supra*. Yet,

> "The Court in *County of Fresno* did affirm, but not simply on the authority of those precedents. Instead, it returned to the source, *M'Culloch v. Maryland*, [17 U.S. (4 Wheat.) 316 (1819)] in an apparent effort to rationalize the analytical framework for determining the scope of the constitutional immunity of federal instrumentalities from state taxation." W. Hellerstein, *State Taxation and the Supreme Court: Toward a More Unified Approach to Constitutional Adjudication?* 75 Mich.L.Rev. 1426, 1436-37 (1977)[9]

M'Culloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819) involved the imposition of a tax by the state of Maryland on notes issued by the Bank of the United States located in Maryland. No other Maryland bank was subject to this tax. While *M'Culloch* invalidated this Maryland tax, in *Fresno*, the Court summarized the reasoning of the *M'Culloch* Court as follows:

> "The Court noted that the power to tax the bank 'by the States may be exercised so as to destroy

[9]This thoughtful article analyzes common doctrinal themes running through recent Supreme Court decisions under the Import-Export Clause (U. S. Const. Art. I, §10), the Commerce Clause (U. S. Const. Art. I, §8, cl. 3), and the Supremacy Clause. The article was very recently cited generally and approvingly by the Supreme Court in an opinion concerning only the Import-Export and Commerce Clauses; *Dept. of Revenue of Washington v. Assoc. of Washington Stevedoring Cos.*, 46 U.S.L.W. 4363, 4370, fn. 27 (U.S. April 26, 1978).

> it,' 4 Wheat, at 427; and consequently that the power to tax, if admitted, could be exercised so as effectively to repeal the Act of Congress which created the bank. If the State's power to tax the bank were recognized in principle, the Court doubted the ability of federal courts to review each exercise of such power to determine whether the tax would or would not destroy a federal function. Finally, the Court rejected the State's argument that the power to tax involves the power to destroy only where the taxing power is abused, and that the Court should simply trust the States not to abuse their power to tax a federal function just as it must trust a State not to abuse its power to tax its own citizens. The Court rejected the argument because the political check against abuse of power to tax a State's constituents is absent when the State taxes only a federal function. A State's constituents can be relied on to vote out of office any legislature that imposes an abusively high tax on them. They cannot be relied upon to be similarly motivated when the tax is instead solely on a federal function." (Footnotes omitted.) 429 U.S. 452 at 458-59.

In upholding the California tax, the Court in *Fresno* formulated a rule for determining when a state tax discriminates against those who deal with the federal government in contravention of the Supremacy Clause, and explained how this rule was based on the *M'Culloch* decision:

> "The rule to be derived from the Court's more recent decisions, then, is that the economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituents of the State. This

> rule returns to the original intent of M'Culloch v. Maryland. The political check against abuse of the taxing power found lacking in M'Culloch, where the tax was imposed solely on the Bank of the United States, is present where the State imposes a nondiscriminatory tax only on its constituents or their artificially owned entities; * * * *" (Footnotes omitted.) 429 U.S. 452 at 462-63.

That the existence of such a political check precludes the existence of the type of discriminatory taxation intended to be prevented by the Supremacy Clause is further evidenced in *Fresno:*

> "A tax on the income of federal employees, or a tax on the possessory interest of federal employees in Government houses, if imposed only on them, could be escalated by a State so as to destroy the federal function performed by them either by making the Federal Government unable to hire anyone or by causing the Federal Government to pay prohibitively high salaries. This danger would never arise, however, if the tax is also imposed on the income and property interests of all others residents and voters of the State." 429 U.S. 452 at 463, fn. 11.

We submit that what this Court is saying in *Fresno* is that a state tax, even though not imposed directly upon the federal government, may still bring about the evil which the Supremacy Clause is intended to prevent, i.e., the destruction of a federal function, if a state is free to tax those who deal with the federal government without concern for offending that state's other citizens. Thus, when this Court speaks of discriminatory taxation of those who deal with the federal government, it is this situation, in

which the state may achieve indirectly what it is prohibited from achieving directly, of which the Court speaks.

The appropriate antidote to this evil, upon which this Court has fastened, is the subjection of a suitable portion of the state's citizens to the same taxes as those imposed upon individuals and companies dealing with the federal government. With the presence of this factor, the unfettered ability of the state to attempt in an indirect fashion what it cannot attempt directly withers, and there no longer exists, for purposes of the Supremacy Clause, a discriminatory situation with regard to state taxation of those who deal with the federal government.

In the present case, then, in order to determine whether the Montana gross receipts tax on governmental construction contractors gives rise to the circumstances in which the type of discrimination prohibited by the Supremacy Clause may arise, this Court should inquire as to whether the taxes imposed are unique to federal construction contractors or are imposed upon a sufficiently broad base of the state's citizens so as to provide an effective *political check* against any abuse of the state's tax power. In the words of this Court in *Fresno*, the inquiry which must be made to determine if impermissible discrimination exists is to ask whether "* * * the tax is imposed equally on other similarly situated constituents of the State" 429 U.S. 452 at 462.

Montana's challenged gross receipts tax is not

imposed upon federal construction contractors because they are construction contractors, but rather because under Montana law, they are "public contractors". In turn, all public contractors including contractors for the United States, the State of Montana, and Montana county or municipal governments or school districts are subject to this tax.[10] Similarly, in *Fresno* the challenged taxes were not imposed because the subject taxpayers were working for the United States Forest Service, but because they were renters of tax-exempt real property and, just as in *Fresno* where the Supreme Court looked at a class of taxpayers defined by the tax itself to determine if all who were similarly situated were treated equally, the Court in this case should look to the class of individuals defined by Montana law as being subject to the challenged taxes to determine if all those situated similarly with federal construction contractors are treated equally under the Montana gross receipts tax.

In the present case, there is no indication that federal construction contractors are treated any differently with respect to Montana's gross receipts tax than any other taxpayer who falls within the larger class of individuals defined as "public contractors" under Montana law.[11] Washington submits that since the class of taxpayers falling within the definition of

[10]R.C.M. 1947 §84-3501(b).

[11]Insofar as the ruling below is premised upon a supposed discrimination based on the ultimate recipient of the state tax revenues, this erroneous conclusion will be addressed in Part II(C) of this Argument, *infra*.

public contractor is and must be significantly larger than just those contractors who contract with the federal government, it seems clear that there exists a more than adequate political check in Montana against any abuse of that state's taxing power. As such, the imposition of Montana's gross receipts tax upon all governmental construction contractors (and not just federal contractors) does not give rise to the type of discriminatory situation prohibited by the Supremacy Clause of the Federal Constitution.

Furthermore, to prohibit the imposition of this tax upon federal construction contractors on the theory that it violates the Supremacy Clause would imbue the Supremacy Clause with an impact which the most recent opinions of this Court have indicated that the Supremacy Clause is not to have. In *Fresno*, this Court noted with respect to the challenged California possessory interest tax:

> "The tax threatens to interfere with federal laws relating to the functions of the Forest Service *only* insofar as it may impose an economic burden on the Forest Service—causing it to reimburse its employees for the taxes legally owed by them or, failing reimbursement, removing an advantage otherwise enjoyed by the Federal Government in the employment market.12
> "12. The Federal Government would otherwise have had the power—enjoyed by no other employer— of giving its employees housing on which no property tax is paid by them either directly or indirectly as rent paid to a landlord who himself paid a property tax." 429 U.S. 452 at 464.

In other words, the bar created by the Supremacy clause to state taxation of those with whom the federal government deals is not intended to provide the federal government with an economically advantageous position from which to deal, relative to other governmental entities. In the present situation, if the Supremacy Clause prohibits the imposition of Montana's gross receipts tax on federal construction contractors, the federal government thereby acquires an advantage enjoyed by no other governmental employer of construction contractors in Montana.

The State of Washington submits that this preferential treatment is not the result which the protections of the Supremacy Clause articulated by this Court in *Fresno* were intended to accomplish or preserve. Moreover, the complete absence in the decision of the majority of the three-judge district court below of any analysis either of the indicia or criteria of "discrimination" within the context of the Supremacy Clause or of the nature of the interest which the Supremacy Clause is designed to protect in situations such as this strongly undermines the validity of any conclusion the court below may have reached as to the presence of perceived discrimination by the Montana gross receipts tax on public contractors against the United States or those with whom it deals.

C. **The Challenged Tax Does Not Discriminate Against the United States Merely Because the United States Does Not Receive Any of the State Tax Revenue.**

As noted earlier, the majority decision below

found that the Montana gross receipts tax discriminates in two ways against the United States or those with whom it deals. In Part II(B) of this Argument, Washington has argued that the nature of the inquiry by the Majority below as to the presence or absence of discrimination as between the United States and private construction project owners was erroneous. In the decision below, the other type of discrimination found to exist by virtue of the Montana tax was premised by the court on the factual circumstance that none of the Montana gross receipts tax revenues are returned to the federal government whereas the State of Montana itself does receive this tax. From this circumstance, incredibly enough, the majority has found prohibited discrimination.

Surely, this conclusion must be wrong. As Circuit Judge Kilkenny observed in his well reasoned dissent:

> "[The majority] erroneously find[s] that the existence of this state revenue works a discrimination against the federal government because there is no corresponding revenue to the federal government. This reasoning, if followed to its logical conclusion, would effectively invalidate the state taxes routinely upheld in *Alabama v. King & Boozer*, 314 U.S. 1 (1941), and *James v. Dravo Contracting*, 302 U.S. 134 (1937)." Dissent, Appendix pp. 27-28.

Washington submits, as the dissent reasons, that the majority below has simply misread the basic test of discrimination set forth in *Phillips Chemical Co. v. Dumas School District*, 361 U.S. 376 (1960).

It is certainly true that in *Phillips*, this Court stated that:

> "It does not seem too much to require that the State treat those who deal with the Federal Government as well as it treats those with whom it deals itself." *Id.* at 385.

Yet, if this test from *Phillips* is to be given the expansive interpretation suggested by the majority below, no state tax of any kind, whether property or excise, which impacted those who deal with the federal government could ever be valid under the Supremacy Clause for the simple reason that the revenues realized by the state in its taxing capacity are never shared with the United States. Yet, in many cases, this Court has upheld various state taxes which are clearly impacting the United States and those with whom it deals yet which do not involve "reverse revenue sharing" to the United States.

Thus, as the dissent suggests, in both *Alabama v. King & Boozer*, 314 U.S. 1 (1941) and *James v. Dravo Contracting*, 302 U.S. 134 (1937), the interpretation of the *Phillips* rationale utilized by the majority below surely would have invalidated the state taxes in question because there was no provision in the state tax statutes for the revenues realized from imposition of the challenged taxes to be returned to the federal government. Of even more direct concern to the State of Washington, the majority decision below is fundamentally inconsistent with this Court's decision upholding the application of Washington's gross receipts tax to construction contractors for the

federal government; see, *Silas Mason Co. v. Tax Commission of Washington*, 320 U.S. 186 (1937).

More recently, in 1977, this Court in *Fresno*, *supra*, upheld California's possessory interest tax as applied to the leasehold interests of U. S. Forest Service employees, even though there was certainly no provision in the California tax statute for return of the proceeds realized from this tax to the United States.

Thus, Washington submits that the majority decision below fundamentally misapplies the *Phillips* test and does so in such a way that if this Court were to affirm this rationale, no state tax of any type could constitutionally be imposed with respect to those who deal with the federal government.

CONCLUSION

For the reasons set forth in this amicus curiae brief, the State of Washington contends that the decision of the majority of the three-judge district court below is in error in concluding that the Montana gross receipts tax on public contractors operates so as to discriminate against those who deal with the United States in contravention of the Supremacy Clause of the United States Constitution.

Accordingly, the State of Washington urges this Court to reverse the decision of the district court and

to uphold the challenged Montana gross receipts tax.

DATED this 4th day of August, 1978.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, GREG MONTGOMERY, one of the attorneys for the State of Washington, as amicus curiae, certify that on the 4th day of August, 1978, I served copies of the foregoing BRIEF FOR THE STATE OF WASHINGTON AS AMICUS CURIAE IN SUPPORT OF THE POSITION OF THE STATE OF MONTANA on appellants and appellees herein by mailing true copies thereof, first class air mail postage prepaid as follows:

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